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U.S. House of Representatives
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CBO'S DEFICIT ESTIMATE FALLS BY \$56 BILLION

QUESTIONS AND ANSWERS ABOUT THE BUDGET AND ECONOMIC OUTLOOK – AN UPDATE

7 September 2004

Q: *What accounts for the decline in the deficit?*

A: A strong economy. The biggest factor in the deficit's decline this year is the surprising growth in tax revenue, which happened because individual and business income are stronger than they were expected to be, according to the Congressional Budget Office [CBO]. CBO's estimates indicate the government will collect about \$54 billion more in revenue this year than expected. That combined with a slight, \$2-billion reduction in outlays compared with the March estimate, results in the \$56-billion deficit decline.

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Q: *Why did the estimated budget deficit decline so much in just a few months?*

A: Again, the answer lies in the strong economy. It is not so much that the economy has performed better than expected – current projections are close to those made in March. Rather, in general terms, the economy's fundamental strength throughout the year has provided a solid foundation for strong and improving revenue collections. Recent economic news has shown that we are in a period of robust economic expansion as strong as at any time in the past 20 years.

In addition, estimators always have exceptional difficulty projecting revenue. Put as simply as possible, this is because the projections depend on anticipating the responses of millions of individual taxpayers to conditions in an economy that totals about \$11 trillion.

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Q: *But still, isn't this \$422 billion the largest budget deficit in the history of our nation?*

A: No. Although this is the largest budget deficit in nominal-dollar terms, it is not the largest budget deficit when taking inflation into account, and using a constant measure that allows comparisons over time. That measure compares the size of the deficit to the size of our economy, or gross domestic product [GDP]. On that basis, the budget deficit is 3.6 percent of GDP. That is large, but by no means is this the largest budget deficit ever. In comparison, in 1983, the budget deficit was 6.0 percent of GDP. (See table, next page.)

Twelve Largest Post-War Deficits
In Billions of Nominal Dollars, and Percentages of Gross Domestic Product

Rank	Year	Nominal Dollars	Percent of GDP
1	1946	16	7.2
2	1983	208	6.0
3	1985	212	5.1
4	1986	221	5.0
5	1984	185	4.8
6	1992	290	4.7
7	1991	269	4.5
8	1976	74	4.2
9	1982	128	4.0
10	1993	255	3.9
11	1990	221	3.9
12	2004	422	3.6

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Q: *Did the tax cuts cause the budget deficits?*

A: No. We would have triple-digit budget deficits today if taxes remained at their historically high levels of 2000. The tax policies put in place in 2001, 2002, and 2003 have helped our economy out of recession. In fact, without our tax policies the economy would not have recovered as quickly and as well as it has. More Americans would have lost their jobs without our well-timed policies. In addition, it is uncertain how much more the drag of a weaker economy would have had on the budget deficits.

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Q: *Are we still on track to cut the budget deficit in half over the next five years?*

A: Yes. The budget resolution adopted by the House accomplishes this goal, and the increase in revenue reported by CBO puts us in even better shape. CBO's figures essentially confirm the point. Extrapolating from these new projections shows the deficit falling to \$215 billion, or 1.4 percent of GDP, by 2009. This is just further proof that if we keep the economy growing, and control spending, we can work toward a balanced budget.

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Q: *Does this mean we can grow our way out of the deficit? After all, if the deficit fell by this much in just seven months, can't the economy balance the budget?*

A: It's not that simple. These 2004 figures prove that a growing economy is part of the equation. But we have to control spending too. Otherwise the government will just keep getting bigger, and eventually taxes won't be able to keep up.

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Q: *Why has spending been growing so rapidly?*

A: This report continues to show the results of all the extraordinary demands placed on our government since September 11, 2001. We've had to respond to terrorist attacks in New York and at the Pentagon, wage two successful conflicts overseas, and continue to fight a global war against terrorism. Those demands have required Congress to spend more money. But our budget holds the line on non-security spending in the government. Spending on lower priority items in the government has slowed dramatically.

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Q: *Do these figures reflect a tax increase?*

A: Unfortunately, yes. Due to conventional practices and certain requirements of law, CBO's "baseline" figures end up showing a scenario that is unlikely to happen. Accordingly, the CBO figures assume automatic tax increases resulting from the expiration of certain tax relief provisions that became law in 2001 and 2003. These automatic tax increases are highly unlikely.

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Q: *Do CBO's assumptions affect the spending side of the ledger as well?*

A: Yes, CBO also assumes that about \$115 billion worth of outlays from fiscal year 2004 emergency supplemental spending – for the war against terrorism and homeland security – will continue indefinitely, even though it was intended as one-time spending. This assumption translates to \$1.433 trillion in higher spending over 10 years.

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Q: *How do CBO's figures compare with those released by the administration in July?*

A: There is a fundamental difference in the way the two agencies develop their figures. The administration figures – released in July by the Office of Management and Budget [OMB] – included projections of the President's recommended policies. For example, these numbers assumed that tax laws enacted in 2001 and 2003 would stay in place permanently, and tax rates would not increase. CBO's figures, on the other hand, assume what is in current law – including tax increases that would occur due to the expiration of provisions of the 2001 and 2003 tax laws.

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Q: *Why are the critics jumping all over these numbers?*

A: The critics want the public to focus on a single number, and ignore the fact that the deficit outlook is improving, just as we said it would. These same critics would like to pretend that the Bush administration invented deficits on its own – and ignore the fact that the administration and Congress have had to respond to the events of 9/11, a war against

terrorism, and to the economic slowdown and recession of 2000-01. All these things had costs and contributed to budget deficits. But the CBO figures show that we are getting this under control – just as we pledged to do.

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Q: *What is being done to restrain spending?*

A: After a dramatic ramp-up in spending due to the war against terrorism, the administration would hold the increase in total discretionary spending to 4 percent. Congress was even tougher in the budget resolution by holding all non-defense and homeland security-related spending to last year's level. The challenge, of course, will be to keep to these levels when the House passes the appropriation bills.

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Q: *Why hasn't Congress adopted tough rules to enforce the budget resolution?*

A: House Republicans passed a budget resolution that holds total appropriations to four percent. Additionally, House Republicans attempted to give these appropriations levels the force of law and to adopt a tough rule against increasing mandatory spending, but *every* House Democrat voted against the bill. Instead of imposing tough limits on spending, Democrats wanted a rule to finance higher spending with higher taxes. Just before the recess, the House Budget Committee, with *no* support from Democrats, used *existing* rules to head off an effort to breach the appropriations limits by \$1.2 billion.

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Q: *Did Congress fail to pass a budget?*

A: The House and the Senate passed their respective versions of the budget way back in March. A majority of the conferees signed off on a conference agreement, and the House passed the conference report in May. The House also, by a separate vote, agreed to abide by the conference report even if the Senate doesn't pass it. A final vote in the sharply divided Senate was held up by Democrats intent on scoring political points rather than governing. By contrast, Senate Democrats failed even to bring their version of the budget resolution to the floor during 2002 when they were in the majority.

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Q: *If the budget outlook has improved, why do we need to increase the debt limit?*

A: The sharp drop in the deficit from previous estimates will take some of the pressure off the need to raise the debt ceiling. Despite the progress in reducing the deficit, the administration estimates it will ultimately be necessary to raise the limit sometime next year. One reason for the increase is that the Treasury Department is required to invest about \$171 billion in fiscal year 2005 in excess Social Security payroll taxes in governmental bonds, which technically increase the nation's debt.